Making the Right Choices in Developing New Futures Contracts

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Where Do You Start?

- What markets/industries have unreasonable risks that they cannot manage? Do they use futures in other areas?
- What are the factors underlying the risk – are they manageable (ie political/country risk is rarely manageable through futures contracts)
- Are there sufficient numbers of buyers, sellers and intermediaries in the market?
- Is the product relatively homogenous?
- Is the industry in question asking for help in managing risks?
- Is there political support for the introduction of a futures contract?
- Is it ‘in harmony’ with your geographic location?

Investigating the Potential Market

- What value does the underlying market have?
- What are the % margins for current players?
- How ‘established’ is the industry/market sector in question?
- Is there enough fear and greed?
- Do your discussions with the market show potential for agreement on what risks needs managing?
- Do the risks for each sector of the value chain lie in the same areas or are they different?
- How will the market cope with potentially massive inflows of foreign funds?
- Feasibility study.......

A Designer Baby

- Leave personal preference out of it – you are not going to trade it so what you **feel** is irrelevant!
- Can the product be standardised? If not forget it......
- Listen to the **market** – not just the strong players (who have good reason to want the contract to fail)
- Collaborative approach can be helpful – UK power
- Establish success criteria early on and agree these with the market.
- Keep the market informed at each step
- Make sure the risk(s) you are intending to manage will not destabilise the market/country/region – are they appropriate?
- Do not rush it.

Contract Specifications

- Its important to know your target market – wholesale or retail?
- This information allows you to set the appropriate contract value and tick size/value.
- Can a trader get in and out making a tick profit and still make money – if not redesign it
- Be guided by other successful contracts in your region (if there are any)
- Delivery months must fit the market – financials or commodities
- Delivery style must be appropriate – eg - do not go for a cash settled commodity contract if the underlying market has no idea what cash settlement is!
- Don’t go ‘me too’ – liquidity is notoriously difficult to move once it is established

Delivery

- A make or break decision
- More an issue with commodities
- For financials make sure that the settlement location is accessible by as many players as possible
- What are the preferred delivery terms for the product (FOB, CIF, ex warehouse, FOT, cash settled etc etc)
- Make sure that the actual delivery reflects the most liquid instrument
- Listen to the market as they are the experts but do NOT be swayed by specific companies or sectors
- You must make the decision - sometimes it will not be popular but the delivery must be fair to all parties

Building Liquidity

- The strength of the clearing house is vital to success – no matter how good the contract specifications are
- Access is key – how will traders become involved
- Who will trade first – you need a mix of traders and hedgers
- Do not expect funds or big speculators until you have established deep liquidity
- Market makers are a good idea – tie them in and ensure that they live up to their commitment (often they do not)
- Trade support is essential – training is often vital
- Proprietary traders are probably the largest volume providers in financial contracts today – what will attract them?

Other Important Factors

- Be prepared to 'borrow' from other markets – there are very few truly innovative product designs!
- If you hire consultants then listen to them – otherwise you are wasting your money
- Be prepared to shout the message again and again and again and again.......and then a bit more.
- Other markets may be interested in you but that is more likely to boost their volume than yours!
- Don't waste time on MOUs unless they mean something – they are distracting
- Its art not science!

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